



## **Ohio Public Employees Retirement System**

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January 4, 2011

Mr. Aristotle Hutras  
Ohio Retirement Study Council  
88 East Broad Street, Room 1175  
Columbus, OH 43215

Dear Aris:

Pursuant to R.C. 145.095, enclosed please find the 2010 annual Audit Committee Report of the OPERS Retirement Board. This report summarizes internal audit activities and identifies actions taken by the Audit Committee during the preceding year.

Please feel free to contact me if you have any questions.

Sincerely,

Chris DeRose  
Executive Director



## **Audit Committee Annual Report**

**To:** Ohio Retirement Study Council (ORSC)

**Subject:** **OPERS Audit Committee Report- 2010**

**Date:** January 3, 2011

The following report documents the activities of the OPERS Audit Committee and Internal Audit Department for 2010. This summary outlines:

- Major Audit Reviews Completed (please see attached schedule)
- Audit Committee Meetings and Actions Taken
- 2011 Annual Audit Plan (priority review areas)
- Special Reviews Completed

### **Summary of OPERS Audit Committee Meetings and Actions**

The OPERS Audit Committee met on the following dates with any specific considerations addressed:

**March 17, 2010-** The audit committee met for the first time in 2010. The composition of the appointed audit committee had changed. The committee reviewed possible changes to the Audit Committee Charter and the Audit Department Charter, as required biennially. Additional considerations were discussed, with approval planned at the next committee meeting.

The committee received the quarterly status report of significant audit issues and recommendations.

The committee received an update on planning for the 2011 Quality Assurance Review (QAR) of the Internal Audit Department by a third party. This is a 5 year requirement, with the last review completed in 2006.

The committee also received an update on the organizational Enterprise Risk program direction, with an emphasis on Audit's role.

**May 19, 2010** – The Clifton Gunderson auditors presented the results of the 2009 OPERS financial examination. In addition, management letter comments on internal controls were presented and discussed with the audit committee.

The committee also received the executive summary of reviews completed during the previous six months with significant audit issue comments presented.

**June 16, 2010-** The audit committee received a report and presentation on the co sourced review of internal derivatives related processes and controls from Investment Training and Consulting Institute (ITCI) and internal audit staff. This comprehensive review focus included portfolio management, compliance with board policies, derivatives accounting processes, valuation, performance reporting and calculations, compliance and risk oversight responsibilities and personal trading controls. Investment audit findings and recommendations presented were reviewed with the audit committee.

In addition, the audit committee received the quarterly status report of significant audit issues and recommendations. Audit follow up items from the internally managed derivatives review were also defined for future Board Scorecard tracking and reporting purposes.

The committee also received updated estimates on potential third party consultant cost options (for budget purposes) in performing the QAR.

**September 30, 2010-** Clifton Gunderson external auditors were present for a preliminary discussion of the planned 2010 OPERS financial examination with the Audit Committee.

The audit committee reviewed and approved the proposed 2011 Audit Plan and risk assessment. The committee also reviewed and discussed the proposed 2011 internal audit operating budget and staffing. This departmental budget will be approved as part of the OPERS overall annual budget process in December, 2010.

The audit committee was also advised Enterprise Risk Management survey results would be forthcoming in November for informational and review purposes.

In addition, the audit committee received the quarterly status report of significant audit issues and recommendations.

**December 14, 2010-** Internal Audit management provided updates on results of the 2010 audit plan.

The audit committee reviewed and approved the 2010 draft of the OPERS Audit Committee Annual Report to ORSC. The committee also received an executive summary report of major audit activities for the prior six months.

In addition, committee reports provided included: the annual report of OPERS Personal Trading compliance; the annual disclosure of all fees paid to external auditor; and the quarterly status report of significant audit issues and recommendations.

## **2011 Annual Audit Plan**

The 2011 audit plan and risk assessment was reviewed and approved by the OPERS Audit Committee at the September 30, 2010 meeting. The priority review areas are summarized on the attached audit plan document.

## **Special Reviews**

The following major review was completed during 2010 with appropriate comments indicated.

Additional internal reviews and follow up within the Investment division was completed. This work was prompted by various review comments and audit recommendations earlier identified in an Internal US Equities review completed.

In addition, Internal Audit staff participated extensively in reviewing all Business Process Redesign recommendations (approximately 450) by internal OPERS staff. This enterprise strategic initiative is geared to improving operational efficiency, quality and customer service expectations through an enhanced technology solution. All appropriate matters were reviewed with the Audit Committee, with key risk recommendations being monitored throughout implementation.

Please let me know if you would like any additional information.

Respectfully submitted:

Gregory M. Januszewski  
OPERS Director- Internal Audit  
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**OPERS INTERNAL AUDIT  
2010 AUDITS COMPLETED**

AUDIT AREA	STATUS OF RECOMMENDATIONS	SIGNIFICANT COMMENTS
Personal Trade Compliance System Program	Recommendations Implemented	Personal Trading Policy changes were approved by Board and annual reporting requirement to Board occurred in December.
Avenue Special Situations General Partner Review	Recommendations Implemented	None
Securities Lending Review	No Recommendations Presented	None
JPMorgan Chase Custody Review	Recommendations Implemented	Issue involving fee overbilling corrected, resulting in significant fee recovery.
Investment Portfolio Guideline Review	No Recommendations Presented	None
Internal Quality Assurance Review (QAR)	Recommendations implemented or on target for completion	Scheduling of an external consultant to review internal audit operations planned for 2011.
eFront Investment System Review	Recommendations Implemented	None
Kronos Payroll System	Recommendations Implemented	None
Pension Benefits Spiking	No Recommendations Presented	None
Investment Invoices Review	Recommendations Implemented	Investment and Legal Divisions contract file process was updated.
Pension Overpayments Review	Recommendations Implemented	None
Inventory Equipment Controls Review	Recommendations implemented	None.
Bloomberg Compliance System Review	Recommendations Implemented or on target for completion	Formal procedures (including training of additional Compliance staff) on writing/editing compliance rules.
Internally Managed Derivatives Review	Recommendations Implemented or on target for completion	The Eagle Star Investment upgrade will ensure a daily compliance testing capability in early 2011. Also, Investment management continues to develop tools for aggregating internal/external manager counterparty risk.
Investment Incentive Compensation	Recommendations Implemented	None
Imaging Process Controls	Recommendations Implemented	Several medium risk areas of improvement were identified during application control review.
New Mountain Partners II and III General Partner Review	No Recommendations Presented	None
Iran/Sudan Investment Policy Review	Recommendations Implemented or on target for completion	The OPERS Board will discuss potential policy revisions and monitoring requirements in December, 2010.

**OPERS INTERNAL AUDIT  
2010 AUDITS COMPLETED**

AUDIT AREA	STATUS OF RECOMMENDATIONS	SIGNIFICANT COMMENTS
HealthCare Third Party Transition	Recommendations Implemented	A Dependent Eligibility review will be completed by a third party in 2011 to verify spousal coverage.
Beacon Capital Partners IV & V Real Estate Review	No Recommendations Presented	None
Real Estate Policy Compliance Review	No Recommendations Presented	None.
Business Process Redesign Enterprise Strategic Initiative and Risk Issues	All Report Recommendations were reviewed with Significant Risk Evaluations completed and presented to OPERS senior management.	Status of all critical risk decisions will be reviewed with OPERS Audit Committee in December.
Ohio Qualified and Minority Manager Policy Review	Recommendations Implemented	Utilization reports identifying use of Ohio managers is now reported to the Board quarterly.
Capital Budgeting Review	Recommendations Implemented	The Project Management Office will begin a validation process, for each project completed, of the initial cost estimates.
Private Equity Policy Review	No Recommendations Presented	None
Payroll and Human Resources Review	Report Pending Review of Recommendations Presented	None
Defined Contribution Elections and Accounting	Review Ongoing	None
Administrative Expenses Review	No Recommendations Presented as a result of Continuous Quarterly Testing	None
Travel Expenses Analytical Data Review	No Recommendations Presented as a result of Continuous Quarterly Testing	Travel trends were examined during the last two years, with favorable results in air fare outliers and lodging costs outside Travel policy limits.
Ethics Review	No Recommendations Presented	Investment business partners and organizational business vendors are complying with policies.
Enterprise Risk Survey	Review and Discussion of Results will be ongoing throughout 2011	Comments on risks have been provided by OPERS management and OPERS board members advised.
Benefit Calculation Quarterly Reviews	No Recommendations Presented as a result of Continuous Quarterly Testing	Outliers identified representing potential pension spiking issues are now routinely referred to Benefits management.
Oak Hill Capital II and III General Partner Review	Review Ongoing	None
Disability Revised Processes	Review Ongoing	None
Mobile Devices and Remote Access	Review Ongoing	Data transfer monitoring on sensitive data downloaded to portable devices is being implemented.

**OPERS Internal Audit Plan  
Detail on Selected Audit Priority Reviews - 2011**

Reporting Entity	Audit Area(s)	Objective
Investments/ Internal Asset Mgmt.	Global Bonds Internal Follow up Review	This review (by internal staff) will utilize previous experience gained in an earlier ITCI review, to perform assessment of the overall processing structure and control network, compliance, etc.
Investments/Internal and External Asset Mgmt	<ul style="list-style-type: none"> <li>* Public Manager Reviews</li> <li>* Private Equity Manager Reviews</li> <li>*Private Real Estate Manager Reviews</li> </ul>	These reviews will continue focusing on investment management agreement compliance, due diligence documentation, investment valuation policy compliance and management reporting.
Investments/Investment policies	<ul style="list-style-type: none"> <li>* Public Equity Policy</li> <li>Public Fixed Income Policy</li> </ul>	These reviews will focus on compliance and management reporting for Board approved Investment policies.
Investments/Total Fund	Incentive Compensation & Investment Performance Calculations	This review is intended to ensure that investment performance reporting is both accurately and consistently reflected based upon investment accounting system and custodian bank reporting, reflected by accurate incentive compensation payments.
Investments/Total Fund	Investment Compliance	Ongoing reviews ( automated routines will be developed where necessary) will address specific policy compliance issues for the asset classes.
Investments/Total Fund	Personal Trading and Outside Boards	Personal Trading Policy adopted by the Board in 2009 and other procedures, now administered by the Investments Division will be reviewed for overall compliance.
Finance- Accounting	Health Care Reporting of Health Care	Reviews will focus on the health care costs/cash flows and the accounting components for the various medical plans.
Finance- Accounting	Centralized Purchasing	Review will assess the revised policy and control structure for the Centralized Purchasing function established.
Benefits BPR Initiative	Streamline Processes	This initiative area review focus will be on organizational efforts to streamline benefit processes.
Health Care	Individual Coverage Changes	This area review focus will be on new individual record and system changes affecting monthly individual allocations.
Health Care	Dependent Eligibility	Health Care to coordinate review with a 3rd party to assess health care retiree database eligibility of member's dependent spouses, etc., with audit oversight.

**OPERS Internal Audit Plan  
Detail on Selected Audit Priority Reviews - 2011**

<b>Reporting Entity</b>	<b>Audit Area(s)</b>	<b>Objective</b>
IT- Audit Applications	Way Forward Applications	This project will be a consulting engagement and application development to test various way forward process changes.
IT- Enterprise	Data and Payment Portal	Review will assess the control structure for the portal to communicate and process payments, transactions affecting multiple retirement systems.
IT- Enterprise	Alternative Plan Design	Review will be completed of system related changes of legislation approved benefit design changes.
IT- Security	Technical Security Review	Engage a 3rd party to assess network security controls.
OPERS - Other	Ethics	This ongoing review will verify that OPERS managers, business partners and vendors are in compliance with Ohio Ethics laws prohibiting gifts to OPERS staff and board.
OPERS- Strategic	Enterprise Planning and Management	Overall Capital Budgeting and project management will be examined in light of specific projects included ( and ongoing) in the OPERS Strategic Plan.